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THE MAEKAWA REPORTS: REALITY OR RHETORIC?

Summary

The rapid and persistent expansion of Japan's current account surplus in the 1980s signaled that the policies the country had pursued for 35 years were no longer compatible with stable world growth. Domestic and external pressures for reform bore fruit in 1986 with the release of the first so-called Maekawa report. Calling for nothing less than a complete restructuring of Japan's economy, its people's lifestyle and the country's global role, the report crystallized the issues facing the nation. While the concepts contained in the Maekawa reports (a follow-up report was issued in 1987) were hailed inside and outside Japan, many wondered whether the Japanese would take the ideas to heart. Two-and-a-half years after the first Maekawa report, many recommendations have become reality. The true test of the report's impact is yet to come, however, since most of the difficult and wrenching changes remain to be attempted.

The 1980s: Turning Point for Japan

Japan's total output of goods and services between 1970 and 1980 nearly doubled in size relative to the United States'-(see Table 1). Then, after holding in the 40-percent range in the early 1980s, the Japan/U.S. gross national product ratio suddenly shot up in 1986 and 1987. Although much of the increase was due to the appreciation of the yen against the dollar, the fact that Japan's economy was now nearly two-thirds the size of America's drove home the point that Japan was no longer a small player in the global marketplace.

Coupled with this increase in relative economic size came a rapid widening of the current account imbalances of Japan, the United States and West

Germany. In the 1970s Japan's modest trade surpluses combined with deficits in services and invisibles to yield moderate current account balances that were in deficit almost as often as in surplus (see Table 2). This pattern held until 1983 when the recovering U.S. economy and a stronger dollar made Japanese exports more competitive in the American market and U.S. exports to Japan more expensive. The U.S. consumption binge drove American and Japanese current account balances in opposite directions to record levels. The magnitude and persistence of these imbalances led to heightened trade frictions between Japan and its major trading partner.

Mirroring the patterns in goods trade, Japan's financial markets began to assert themselves globally. The growing Japanese economy generated internal and external pressures for the reform of financial regulations. At home, bulging corporate coffers, burgeoning government debt recycling demands and increasingly multinational corporate operations led a broad coalition of financial and nonfinancial companies to press Tokyo for changes. At the same time, Japan's expanding economy acted as a magnet, attracting increased interest from foreign firms. In order for domestic as well as foreign companies to operate more efficiently in Japan, a broad program of deregulation was critical.

The government found itself increasingly out of step with the new economic needs. The panoply of regulations that had insulated the country from external disturbances -- or moderated their impact -- during the difficult period after World War II had become a stifling blanket, threatening to strangle the competitive vitality and technological innovation universally viewed as the key to Japan's future prosperity. The government's continued control of the domestic telecommunications market (through Nippon Telegraph and Telephone Public Corp.), a large part of the country's railroads (Japanese National Railways), and the domestic tobacco market (Japan Tobacco and Salt Public Corp.) became symbols of how the government was obstructing economic progress.

The central government general account budget deficit also drew criticism as the cost of servicing the outstanding debt escalated. Up until the mid-1960s Tokyo's balanced budget minimized debt concerns. After a brief surge in the deficit to counteract the 1965-67 economic slowdown, Tokyo limited new debt issues to well under 10 percent of the annual budget until 1971. In response to the twin oil shocks and ensuing global recession, however, Tokyo embarked on a strongly stimulative fiscal policy. The share of the annual general account budget financed through borrowing rose rapidly from 4.2 percent in FY 1970 to 12.4 percent in FY 1971, reaching 25.4 percent in FY 1975 and hitting a high point in FY 1979 at 34.7 percent. By 1980 the outstanding debt was equivalent to 29.3 percent of gross national product, and debt service outlays had risen to 14.2 percent of the annual budget. As the debt issued in the early 1970s came due, the debt-to-GNP ratio topped 40 percent in FY 1984. It has remained there, equaling the scale of the U.S. budget deficit.

By the mid 1980s, therefore, Japan had reached a critical point. Old policies and regulations, which had served so well in rebuilding the war-torn economy, were no longer suitable or could not be maintained. Furthermore, conflicting information bombarded the average Japanese worker. On the one hand, the Japanese press and the government loudly trumpeted Japan's new status as an

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Table 1: Real Gross National Product, Japan and the United States*

(in billions of dollars and percent)

Year	United States	Japan	Japan/United States Ratio
1955	$1,281.4	$93.0	7.3%
1960	1,427.4	139.8	9.8
1965	1,789.4	251.0	14.0
1970	2,071.1	422.8	20.4
1975	2,310.1	634.1	27.4
1980	2,732.0	1,058.1	38.7
1981	2,784.7	1,127.8	40.5
1982	2,713.8	1,029.4	37.9
1983	2,810.7	1,114.5	39.7
1984	2,991.4	1,171.0	39.1
1985	3,093.3	1,220.8	39.5
1986	3,150.1	1,771.0	56.2
1987	3,274.9	2,153.9	65.8

*1980 prices.

Source: International Monetary Fund, International Financial Statistics

Table 2: Japan's Trade and Current Account Balances, 1970-87

(IMF basis, millions of dollars)

Year	Exports	Imports	Trade Balance	Current Account Balance
1970	$18,969	$15,006	$3,963	$1,970
1971	23,566	15,779	7,787	5,797
1972	28,032	19,061	8,971	6,624
1973	36,264	32,576	3,688	-136
1974	54,480	53,044	1,436	-4,693
1975	54,736	49,706	5,028	-682
1976	66,026	56,139	9,887	3,680
1977	79,333	62,022	17,311	10,918
1978	95,634	71,038	24,593	16,534
1979	101,232*	99,387*	1,845*	-8,754
1980	126,736	124,611	2,125	-10,746
1981	149,522	129,555	19,967	4,770
1982	137,663	119,584	18,079	6,850
1983	145,468	114,014	31,454	20,799
1984	168,290	124,033	44,257	35,003
1985	174,015	118,029	55,986	49,169
1986	205,591	112,764	92,827	85,845
1987	224,605	128,219	96,386	87,015

*Processing fees and net receipts on merchandise transactions excluded from export, import and trade balance data from July 1979.

Source: Ministry of Finance

economic superpower. On the other, the nation's standard of living remained well beneath that enjoyed in Western industrialized countries. This discrepancy generated calls for the country to turn its attention to the quality of life rather than overall economic growth.

The Maekawa Commission

Responding to these forces, then-Prime Minister Yasuhiro Nakasone commissioned a personal advisory panel October 31, 1985 to study what Japan should do to meet its new international and domestic obligations. Haruo Maekawa, former governor of the Bank of Japan, chaired a commission of appointees with reputations for open minds and forward thinking in their fields of business, academia and government. After a little more than five months of work, the panel released its first report April 7, 1986. It called not just for new policies but for a thorough restructuring of the nation's economic structure.

The Advisory Group on Economic Structural Adjustment for International Harmony, as the Maekawa commission was formally known, set a new goal for the nation: to steadily reduce the huge current account surplus to one consistent with international harmony. (For a complete summary of the first report, see the Appendix). Linking the imbalance to "Japan's economic structure, which is export-oriented," the group called for a structure "oriented toward international coordination" but one that also enhances "the quality of the nation's living standard." The restructuring effort should be based on three principles, the report said: the use of open market mechanisms wherever possible; the coordination of domestic restructuring with the adjustment policies of foreign nations; and the consideration of restructuring as a long-term, continuous process, but one that must be started immediately.

The panel's recommendations will be dealt with in detail later in this report. Briefly, the main points were:

- Expand domestic demand to reduce dependence on external demand and improve national living standards. This includes promoting housing development, stimulating other forms of private consumption and encouraging investment in social infrastructure.

- Restructure domestic industry to match new economic conditions. This section encourages firms to focus on meeting domestic rather than external demand, promotes direct investment abroad and urges more imports of agricultural goods.

- Increase imports of manufactured goods. Reducing tariffs, streamlining standards and certification procedures, simplifying the distribution system and pursuing antimonopoly policies are some domestic tasks. Internationally, Japanese companies should promote technology exports, engage in more cooperative ventures and refrain from disruptive behavior, such as the pursuit of "expanded market share at all costs."

- Stabilize exchange rates and liberalize capital markets. International policy coordination is the key to achieving steady exchange rates, particularly in the "elimination of major disparities in the economic performance of leading industrialized countries" that generate pressure for realignment. Japan's financial role must be "commensurate with its economic importance." Diversification of instruments and proliferation of secondary markets are important goals.

* Promote international cooperation and contribute to the world economy in line with its new position. Japan must play a larger role in aiding developing countries, solving the Third World debt problem, providing foreign aid, promoting scientific and cultural exchanges, and supporting the current round of multilateral trade negotiations under the auspices of the General Agreement on Tariffs and Trade (the Uruguay Round).

* Pursue flexible fiscal and monetary policies while reducing the national budget deficit. Not only must the government "end its dependency on deficit financing bonds," but it must "achieve economic and social balance" while mobilizing "private sector vitality" through deregulation. On top of this, the tax system should be reviewed with an eye toward equity, fairness and simplicity. Incentives for saving also should be reduced.

The initial international reaction to the first Maekawa commission report was positive but cautious. U.S. administration and congressional observers agreed that the report could indeed represent a "historical transformation" of Japan's economy if fully implemented. The reaction from Europe was similar. Hailing the ideas, West Germany, France and the European Commission were willing to give Japan a chance but waited for action before making a final judgment. Britain, on the other hand, brushed off the report because it lacked specific details.

The domestic response was even less assuring. Candidates for Mr. Nakasone's job within his own Liberal Democratic Party blasted the ideas; ironically, they felt there was too much detail. Anxieties heightened when Mr. Nakasone "explained" the report to President Reagan since the politicians were concerned that Mr. Nakasone had committed the nation to actions that were still being discussed. The business community also was ambivalent, with many pointing out that the report's recommendations could lead to increased unemployment, higher business taxes and reduced international competitiveness. Businessmen did admit that it might be time for the Japanese to begin enjoying life a little more, but they were widely split as to the wisdom of dropping incentives to save.

To address the foreign concern about a dearth of specifics and the domestic political realities that require a national consensus before shifting policies, Mr. Nakasone asked Mr. Maekawa to continue to study the problem and to develop more concrete details under the auspices of a government advisory body, the Economic Council. (The fact that the first Maekawa panel was merely an informal advisory body to the prime minister detracted from its message.) The result, drawn up by the Special Committee on Economic Restructuring, was released almost exactly one year after the initial report -- April 23, 1987. (See the Appendix for a full summary of the second Maekawa report.) It added the following points to the first report's framework:

* The government should promote domestic demand by increasing funding support and tax breaks for home buyers as well as encouraging more companies to enter the homebuilding market to enhance competition and supply.

* Land use must be reconsidered, including agricultural land in urban areas, urban redevelopment and the use of landfills. Government also must aid depressed regions of Japan and strive to develop attractive alternatives to Tokyo and other existing metropolitan centers.

• The government should promote domestic consumption by seeking adequate wage growth and price stability and ensuring that the benefits of the yen's appreciation are passed on to the consumer, particularly where government corporations are involved.

• The government should help shorten the workweek by setting a national average of 1,800 work hours a year plus 20 days of vacation annually by the year 2000. To deal with unemployment that may be induced by restructuring, a "Japanese worksharing" system featuring shorter hours and a "redistribution of employment across generational lines" was urged.

• The "hollowing out" of the Japanese economy as a result of the restructuring process should be discounted. This idea reflects old economic realities and does not meet with current or future needs, the report said.

• Reform was targeted for the distribution system plus the petroleum, construction, agriculture, transportation and telecommunications industries. In regard to agriculture, the report recommended improving government controls "so as to expand trading in independent-market rice, [and] to introduce competitive principles in all stages from collection to marketing." The explicit mention of this politically sensitive domestic issue is worth noting. At the same time, however, the report also called for steps "to establish agriculture as a viable industry." Greater emphasis on consumer concerns and reducing the gap between domestic and foreign prices for food items were two other areas of importance.

• Japan must increase its role in supporting global free trade, solving the Third World debt crisis and providing development assistance. The report also called for a greater Japanese role in adding to mankind's basic scientific understanding, supplying "international public works" and revitalizing "Japanese education with expanded acceptance of foreign educators and educational and research institutions."

This follow-up report was applauded overseas for its suggestions as well as its ideas. Along with specific steps, it set deadlines for some goals. While foreigners found this encouraging, the Japanese public was suspicious of such detail since many uncontrollable and unpredictable factors are involved. Nevertheless, the recommendations matched the mood of the nation and helped spur further debate.

It is clear that the second Maekawa report went beyond targeting critics who wanted details, however. When members of the second commission met with Prime Minister Nakasone to review the report, they openly criticized the government as a captive of vested interests. Frustration with the government's failure to act on the ideas encompassed in the first report during the intervening 12-month period was evident in the second report's listing (and repeating) a number of specific steps that the government should take.

Maekawa at Two-and-a-Half: The Reality

In examining what Japan has done to implement the Maekawa recommendations, three points should be kept in mind. First, only 30 months have passed since the first report was issued, even less if the year between reports is discounted. It would be unrealistic to expect Japan to restructure within 30 months an economic edifice that took 40 years to build. It would be equally fantastic to expect the speedy development of a national consensus on policy

changes that reflect the nature of Japan's new global role. Second, the report's ideas corresponded to moves that had already been taken in several areas, the most important being financial liberalization. In these areas, near-complete implementation is not surprising. Finally, many of the objectives are beyond Tokyo's control. The report deals with the behavior not only of Japanese corporations but also of individual citizens and foreign countries. To expect these entities to modify their actions to conform to the Maekawa recommendations may be asking too much.

To evaluate Japan's progress toward the Maekawa goals, each point of the initial report will be examined in the original order with two exceptions; evaluations of the ultimate goals and overall principles will be reserved for last. Where appropriate, objectives or recommendations from the second report also will be included in an attempt to provide a unified picture.

Expanding domestic demand - While it really is too early to tell for sure, initial signs are modestly encourging that domestic demand is playing a bigger -- indeed, the dominant -- role in growth. Domestic demand actually has accounted for the majority of Japanese growth in all but three years since 1966 (see Table 3). The true impact of external demand, however, is masked since it is impossible to separate the amount of domestic capital formation intended to produce exports from that designed to supply the domestic market. From another

Table 3: Contribution to Real Gross National Product Growth, 1966-87

(in percent)

Year	GNP Growth	Domestic Demand	Net External Demand
1966	10.5%	10.8%	-0.3%
1967	10.4	12.8	-2.4
1968	12.5	12.4	0.1
1969	12.1	12.2	-0.1
1970	9.5	10.9	-1.4
1971	4.3	3.7	0.6
1972	8.5	9.5	-0.9
1973	7.9	10.9	-3.0
1974	-1.4	-2.6	1.2
1975	2.7	0.7	1.9
1976	4.8	3.8	1.0
1977	5.3	4.5	0.9
1978	5.2	6.1	-0.9
1979	5.3	6.7	-1.4
1980	4.3	0.9	3.4
1981	3.7	2.2	1.5
1982	3.1	2.8	0.3
1983	3.2	1.7	1.5
1984	5.1	3.7	1.3
1985	4.7	3.7	1.0
1986	2.4	3.9	-1.4
1987	4.2	4.9	-0.7

Note: Figures may not add up due to rounding.

Source: Economic Planning Agency

standpoint, while consumer spending picked up some steam between 1984 (a 2.7 percent gain in price-adjusted terms) and 1987 (a 3.9 percent increase), the growth in this component has generally been smaller than the overall rate of GNP expansion (except in 1986 when personal consumption rose 3.2 percent and overall real growth was only 2.4 percent).

In terms of expenditures by average households, the picture is also mixed (see Table 4). Expenditure growth slowed to a crawl in 1987, both in nominal and real terms, while savings continued to increase. On the other hand, retail stores and supermarkets report that sales have risen steadily in 1988. The stability of consumer prices has been remarkable in comparison to other industrialized countries, but the Maekawa commission called for more. Analysts argue, for example, that the gains from the appreciation of the yen must be passed on to the consumer. Tokyo has done what it can by encouraging utilities to reduce rates as the yen cost of imported energy has plunged and by urging distributors and retailers to reduce prices on imported goods as much as possible. The jawboning is having some effect, but there is widespread agreement that more needs to be done in order to achieve the Maekawa goals. According to the Bank of Japan, import prices dropped 35.8 percent in 1986 and another 8.3 percent in 1987 while domestic wholesale prices fell only 4.7 percent and 3.1 percent, respectively. On certain imported items, however, Tokyo claims that as much as 60 percent of the benefits of the yen's appreciation has been passed on to the consumer.

Table 4: Changes in Income and Expenditure by Workers' Households, 1982-87

(percent change from previous year)

Year	Income	Living Expenditure	Recreation	Savings	Consumer Price Index
1982	7.1%	7.5%	6.5%	1.4%	2.8%
1983	3.2	3.1	3.1	7.8	1.8
1984	4.6	4.1	5.0	0.1	2.3
1985	9.7	3.8	2.6	16.2	2.0
1986	1.8	1.8	3.5	6.4	0.6
1987	1.7	0.6	-0.3	6.7	0.1

Source: Statistics Bureau, Management and Coordination Agency

Ambiguity in the consumption data points to one area where Japan has failed to measure up to the Maekawa report: wage increases. Wages and productivity growth seem to have no relation. In annual negotiations labor unions have been unable to win increases that match, much less surpass, productivity advances. The government has been urging the business community to be more generous, but it is also sympathetic to claims that excessive wage growth will reduce Japan's international competitiveness. The capture by corporations rather than workers of productivity gains would seem to work against greater personal consumption and improved living standards as urged by the Maekawa reports.

Efforts to increase home ownership have been made, but the impact is questionable. Tokyo has increased the funds available for home buyers through

the government's Home Finance Corp.; it also is permitting banks to securitize home loan portfolios to increase such lending. Private residential construction has made a positive contribution to GNP growth since 1985, especially in 1987 when it recorded 20.6 percent real growth. However, problems remain. While the government took measures to curb skyrocketing land and housing prices in the Tokyo metropolitan area in 1987, housing in this market remains out of the reach of most Japanese. The continuous growth of Tokyo -- the most populous region of the country -- has become a major problem. In addition, little has been done to encourage new firms to enter the homebuilding market, a suggestion of the second Maekawa report. There is disagreement as to whether such promotion is necessary, given the large number of contractors in Japan, but Tokyo may take action if the variety of available housing does not increase in coming years.

Working hours generally continue at previous levels despite jawboning by Tokyo. The average Japanese still puts in over 2,100 hours a year, while his American counterpart puts in around 1,900 hours and a West German worker just under 1,700. Banks have just begun to close on Saturdays, and government offices will follow soon. Japanese manufacturers, worried about international competitiveness, are likely to be the last to climb on board; average hours worked in the manufacturing sector actually rose in 1987. It will be a long haul to attain the Maekawa report's goal of 1,800 hours of work a year plus 20 days of vacation.

Restructuring domestic industry - This is certainly one of the most difficult objectives, and one that takes time. According to the Ministry of International Trade and Industry (Table 5), the ratio of exports to total domestic production hit a peak in 1984 at 26.5 percent for the processing and assembly sector and 36.4 percent for manufacturing. MITI expects the ratio to decline but still forecasts that overseas demand will absorb more than 20 percent of output at the end of this century. Confusing the picture are positive signs, such as higher domestic sales of cars versus exports for the first time in many years.

Table 5: Japan's Export Dependency Ratio*

(in percent)

Year	Manufacturing	Processing and Assembly
1975	31.8%	22.7%
1980	35.6	24.7
1984	36.4	26.5
1990 projected	34.5	24.7
1995 projected	29.2	21.1

*Ratio of total exports to total production.

Source: Ministry of International Trade and Industry

Some sign of change also is apparent from an aggregate viewpoint (Table 6). There was a natural downward trend in the secondary sector's (mining, construction and manufacturing) share of gross national product and a rise

in the tertiary sector's (such as finance, services, transportation) as Japan evolved from an industrial to post-industrial economy. In 1986, however, the secondary sector dropped sharply to 30 percent of the economy's output from 36.2 percent in 1985 due to the shrinkage of the manufacturing sector to 21.6 percent from 28.7 percent.

Table 6: Japan's Gross National Product by Sector*

(in percent)

Year	Primary	Secondary	Of Which: Manufacturing	Of Which: Other	Tertiary
1970	5.9%	43.2%	34.9%	8.3%	50.9%
1975	5.3	38.8	29.1	9.7	55.9
1980	3.6	37.7	28.2	9.5	58.7
1985	3.0	36.2	28.7	7.5	60.8
1986	3.1	30.0	21.6	8.4	66.9

*Nominal GNP

Source: Economic Planning Agency

The export psychology has proved very resistant to change, however. For three years in a row, a majority of Japan's non-financial companies responding to an Economic Planning Agency survey said they planned to maintain or increase exports. Corporate profit projections for FY 1988 and coming fiscal years indicate that exporters have adjusted to the stronger yen. According to a June 28, 1988 Nihon Keizai Shimbun survey, export-dependent firms expect solid profit growth next year if the yen remains at the Y130=$1.00 level. Most domestically oriented firms, in contrast, expect only modest gains under the same conditions. Ironically, MITI data show that exports have declined in profitability in comparison to domestic activities.

Japanese firms have begun to diversify. A recent Japan Fair Trade Commission survey shows that the ratio of original lines of business to total sales has declined in many industries since 1979. The survey does not show, however, whether the diversification has been oriented toward domestic or foreign demand.

It also is unclear if Japanese firms have stopped "pursuing market share at all costs," as the Maekawa report proposed. The number of dumping complaints filed against Japanese exporters in the United States has gone up somewhat in the last year or so as firms have tried to hold the line on price increases in the face of the yen's appreciation. Japan's integrated circuit makers certainly seem chastened by their experience with American complaints that they were buying U.S. market share in memory chips in the mid-1980s, and they have restrained their production competition for the current generation of chips. Moreover, after eight years of "voluntary" restraints, Japanese car makers are also more sensitive to the impact of exports and are making an increased commitment to overseas local production.

Deregulation has certainly become part of Japan's economic policies, although the Maekawa commission cannot take all the credit. In fact, Mr. Nakasone, when he was prime minister, had appointed another panel to focus on "administrative reform" of the government -- an idea that centers on privatizing major public enterprises, specifically Nippon Telegraph and Telephone, the Japanese National Railways and Japan Tobacco and Salt. In the cases of NTT and JTS, privatizing the public monopolies meant deregulating the domestic market and opening it to foreign as well as domestic competition. Although implementation hit some rough spots as the United States pressed to assure equal opportunities for foreign companies, the liberalization of the domestic telecommunications and tobacco markets has yielded benefits to all sides. Consumers now have a much greater choice of products at generally lower prices; foreign firms have been able to export more to Japan; and domestic companies have diversified to take advantage of new opportunities or availed themselves of new products and services.

International harmony - Encouraging the "international division of labor" entails several shifts. First, analysts agree, Japan must stop producing goods where it has lost comparative advantage. Japan's coal industry, for example, is scheduled to be phased out in a few years. Downsizing of other industries, such as aluminum and petroleum refining, is also being encouraged, a process that may be affected by the June 1988 expiration of the depressed industries law (see JEI Report No. 30B, August 5, 1988).

In turn, Japanese investment in overseas production facilities establishes subsidiaries and ties that encourage more imports, which can substitute for domestic goods, and aids in global growth. The government has not had to lift a finger to encourage firms to increase direct investment abroad. The latest figures from the Finance Ministry indicate that offshore investment grew 49.5 percent in FY 1987 (see JEI Report No. 23B, June 17, 1988). In addition, while investment in overseas manufacturing facilities fell in FY 1985 and FY 1986, it rose to 23.5 percent of all foreign direct investment in FY 1987. Most economists predict that foreign direct investment will continue to expand at a healthy clip as Japan restructures.

Tokyo also has actively supported the Multilateral Investment Guarantee Agency as recommended by the Maekawa report. MIGA was established by members of the World Bank to issue guarantees against non-commercial risks to participants that invest in member developing countries (see JEI Report No. 22B, June 12, 1987).

To ease the way for foreign investors in Japan, regulations governing foreign investment have been liberalized and sources of investment information and insurance improved. Ministry of Finance approval of almost all foreign investments is automatic, and foreign ownership in previously sensitive industries is allowed. Prefectural governments are trying hard to attract foreign investment, mounting promotion missions overseas and providing incentives and guidance.

As for importing more agricultural commodities, the process of liberalization is moving ahead. This past June Tokyo agreed to free imports of beef, oranges and orange juice by the early 1990s (see JEI Report No. 24B, June 24, 1988). A month later it agreed to phase out the quotas on seven categories of processed foods (see JEI Report No. 29B, July 29, 1988). These arrangements leave rice as the only important agricultural commodity not targeted for liberalization at the present time.

In terms of the price of food in Japan, the rate of progress leaves something to be desired. Aside from rice, beef and a short list of other products, however, there is little the government can do directly to lower food prices since these prices are heavily influenced by the cost of distribution (which will be discussed later). Inspection requirements and health standards can modestly influence the price of some products, particularly imported ones. Tokyo has not completely eased these regulations to benefit food imports or Japanese consumers.

Increasing foreign access to Japan's markets - Over the past 30 months Tokyo has moved to reduce tariffs and streamline standards and certification procedures to promote imports in general and manufactured imports in particular. Tokyo's July 1985 "action program" and the deregulation of telecommunications and tobacco markets have addressed these points to varying degrees. As shown in Table 7, the ratio of imports to GNP began growing even before the Maekawa report. Balance of payments statistics and customs clearance data both show that the value and the volume of imports have been recording healthy increases. MITI surveys report that imported goods are taking a greater share of the space in warehouses and on retailers' shelves (rising from around 10 percent in FY 1983 through FY 1985 to 13 percent in FY 1987). Manufactured products now account for close to 50 percent of total imports. This trend is likely to continue given the interest by domestic corporations in importing

Table 7: Ratio of Exports and Imports to GNP, 1966-88

(in percent)

Year	Exports	Imports
1966	7.6%	12.0%
1967	7.3	12.4
1968	7.9	13.3
1969	8.5	13.4
1970	9.1	14.9
1971	10.1	15.1
1972	9.9	15.3
1973	9.8	17.6
1974	12.2	18.9
1975	12.0	16.6
1976	13.2	16.7
1977	13.9	16.4
1978	13.1	16.4
1979	13.2	17.6
1980	14.9	15.9
1981	16.6	16.1
1982	16.7	15.9
1983	16.8	14.6
1984	18.8	15.4
1985	18.9	14.7
1986	17.6	14.9
1987	17.4	15.4
1988:I	17.6	16.4
1988:II	17.1	17.4

Source: Ministry of International Trade and Industry

items from their own overseas subsidiaries. Yet, although Japan's import performance has improved, it still has a way to go to match the manufactured import ratio of the United States or West Germany (see JEI Report No. 14A, April 8, 1988).

In contrast, actions to simplify the distribution system and to pursue antimonopoly policies more diligently are at the initial stage. As far as the distribution system is concerned, many in Japan do not feel it is a problem. They admit the system is complex and costly, but it certainly works. MITI, however, has begun discussions with the private sector on reforming laws that restrict the growth of large retail stores. MITI also is investigating how to help foreign firms penetrate Japan's distribution system.

Antimonopoly policy has always been a poor stepchild to MITI's industrial development programs. In light of the growing emphasis on consumer rights and concerns, however, the Fair Trade Commission can be expected to play a more vigorous role. Awareness of how domestic oligopolies have influenced prices is growing among Japanese consumers as low-price imports become increasingly available. For some products, such as film and small electronic items, discounting has become generally accepted. It may not be too long before "manufacturer's suggested retail price" takes on the same relevance in Japan as it does here -- a standard to measure bargains against.

Stabilizing exchange rates and liberalizing capital markets - International policy coordination has achieved orderly adjustments of exchange rates. The September 1985 agreement of the Group of Seven industrialized nations tempered exchange market volatility in 1986 and 1987 as the yen sought new levels against the dollar and other major currencies. As for helping stabilize exchange rates by the "elimination of major disparities in the economic performance of leading industrialized countries," Tokyo cannot be accused of shirking its duty. Spending on public works projects has been raised, and the public sector has made positive contributions to overall economic growth when it was called for.

On pursuing a financial role "commensurate with its economic importance," Tokyo also can claim many achievements. The catalyst for financial reform was the May 1984 yen-dollar accord. This agreement committed Japan to deregulate important interest rates, provide greater foreign access to its equity markets, reduce restrictions on the financial activities of Japanese corporations and develop new markets. By the time the first Maekawa report was released, diversification of financial instruments was well under way. Preparations also were being considered for new markets, such as the bankers' acceptance market, an offshore banking market, a market for commercial paper and financial futures trading. Tokyo's efforts to develop secondary markets, particularly for government bonds and notes, have been less successful. Residual restrictions and other institutional factors have hindered their expansion.

After several years of incremental changes, Japan's financial markets have clearly come a long way from their structure at the start of the decade. The number of foreign financial firms operating in Japan has at least tripled and continues to grow. Japanese banks and securities companies have quickly made their presence felt on markets around the world. There is no doubt that much remains to be done, but the country is so far down the road to deregulation that it is impossible to turn back. (See JEI Report No. 6A, February 12, 1988, and JEI Report No. 35B, September 16, 1988, for details of Japan's recent financial reforms.)

Promoting international cooperation - In this area, too, Japan has come through on most of the Maekawa recommendations. Japan has taken a bigger role in aiding developing countries, particularly through increasing contributions to multilateral organizations such as the International Monetary Fund, the World Bank and the Asian Development Bank. In addition, it has drastically increased its official development assistance to the point where Japan's aid budget for the current fiscal year is larger than the United States'. Japan's contribution will continue to grow. The third ODA doubling plan now in effect commits Japan to pour $50 billion into development assistance over the 1988-92 period.

Solving the Third World debt problem also has occupied government planners. The Miyazawa Plan, described at a late September IMF meeting (see JEI Report No. 38B, October 7, 1988), represents an original proposal by the Japanese, although it is designed to complement the Baker Plan supported by the United States. However, the initiative remains in the initial discussion stage.

Tokyo also is actively supporting the current round of multilateral trade negotiations. Although it certainly has differences with the United States and the European nations, particularly on agricultural trade, the three are in general agreement on the expansion of GATT coverage to intellectual property and financial and services trades. Tokyo also is positioning itself to play the role of mediator between Western industrialized countries and developing nations, particularly those from Asia.

Moreover, Japan is expanding its contributions in the areas of science and culture. Cultural exchanges always have been an integral part of Japan's foreign policy, but funding has sometimes been lacking. Japanese corporations, organizations and even private citizens are now sponsoring cultural programs overseas. In the United States, subsidiaries of Japanese firms have slowly realized that more is expected of them than just providing goods and services; they are beginning to contribute to the social and cultural life of local communities.

On the scientific side, Japan is trying to repay its research debt to Western countries, particularly the United States, by sponsoring projects such as the Human Frontier program, which funds foreign research on basic biological questions. Tokyo also has tried to interest foreign companies in joint public-private research projects in superconductivity, optoelectronics and other areas. The main barrier to more foreign researchers in Japan seems to be the high cost of living there. Tokyo is unwilling to spend its scarce budget resources on subsidies. On the other hand, Japan continues to act as a rich source of technology for developing countries, especially in Asia. Government and corporate efforts to widen the flow to include Africa and South America have just begun and should show results within a few years.

Pursuing flexible fiscal and monetary policies - Tokyo has done surprisingly well in adhering to the overtly contradictory Maekawa ideas to "end its dependency on deficit financing bonds" while stimulating domestic demand. Budget figures for the past several years show that the government has held down the growth of discretionary spending but rearranged budget allocations to raise public works expenditures. (See JEI Report No. 18A, May 6, 1988 for a detailed breakdown of Japan's central government spending.) Spending priorities of the Fiscal Investment and Loan Program, a separate capital budget, also have been reordered to emphasize domestic stimulation. Although the debate over the

wisdom of eliminating government borrowing to cover current expenditures continues to rage, Tokyo appears to be set on this course for at least the next few years.

In terms of tax reform, Japan's record is spotty. Personal income taxes were cut for 1987 and 1988, but the ruling Liberal Democratic Party has been stymied in its efforts to win Diet approval for wide-ranging reform. All debates accept the Maekawa principles of equity, fairness and simplicity, but consensus evaporates when it comes to actual measures to achieve these goals. The government's only success according to the Maekawa criteria is the abolition of the maruyu system of incentives for saving. These tax-exempt accounts for small savers were abolished April 1 of this year. The impact on the personal savings rate appears to have been zero. In fact, by forcing savers to become more conscious of interest rates and other investment options, the change may end up increasing the excess funds generated by the household sector.

The Liberal Democratic Party introduced major tax reform legislation during the 1987 and 1988 Diet sessions. Both times, opposition parties were able to prevent passage by stalling and using obstructionist tactics as well as whipping up anti-tax sentiment among voters. Undaunted, Prime Minister Noboru Takeshita opened a special Diet session in July for the express purpose of adopting tax reforms in the face of major political obstacles. The package under consideration would substitute a 3 percent general consumption tax for many current commodity taxes, reduce levies on alcoholic beverages, tax capital gains more heavily and cut inheritance taxes -- all steps aimed at improving the fairness of the tax system (see JEI Report No. 24B, June 24, 1988). While chances are good that Mr. Takeshita will win approval by the end of November (see JEI Report No. 37B, September 30, 1988), the changes represent only the first step in fulfilling the Maekawa vision.

Meeting the ultimate goal - Has Japan succeeded in expanding domestic demand to reduce its dependence on exports? Yes and no. Clearly the net external sector has been a drag on the economy since the beginning of 1986, leaving domestic demand to power the economy (Table 3). Trade, however, continues to represent a good chunk of Japan's economic activity. Exports as a percentage of GNP, for example, have only fallen from 18.9 percent in 1985 to 17.1 percent in the second quarter of 1988 (Table 7). From this and corporate business plans, it appears that Japanese exporters do not plan to reduce exports, at least in value terms.

Has the standard of living improved? It is too early to tell. Although the Japanese enjoy consumer appliances and electronic luxuries to a similar degree as citizens in Western industrialized nations, Japan's stock of social capital (parks, roads, and sewers, for example) is far smaller than its peers' (see Table 8). In other respects, the average Japanese is beginning to enjoy leisure activities to a greater degree than before, particularly foreign travel. The high numbe of working hours, however, remains a problem.

Tokyo's adherence to the general principles of the Maekawa reports has been generally good, even if the pace of change seems glacial in some cases. Certainly in the area of financial market liberalization, greater use of open market forces has become the buzzword. As for a global perspective, the Japanese are still grappling with the concept. Kokusaika or "internationalization" is the latest thing in corporate and personal outlooks. Ask the average Japanese what this means, however, and you will get vague or contradictory answers. Insularity and ethnocentrism lie very close to the center of Japanese self

perception -- the group orientation of society ensures that there is always an "us-them" distinction. This does not mean that Japan is insincere about its international responsibilities or that it will not bear them in good faith. It does probably mean that Japan will pursue these goals in ways different from the United States. There is almost universal Japanese agreement that the process of restructuring and adjustment is a long-term project. The conflict comes in deciding what immediate steps to take.

Table 8: International Comparison of Social Capital

	Japan	United States	Great Britain	West Germany	France
Consumer Durable Goods Index	124.3	135.5	100.2	97.9	66.4
Social Capital Index	40.6	101.8	111.7	112.8	73.7
Paved Roads (percent)	57.7 (1985)	85.0 (1981)	100.0 (1984)	99.0 (1983)	95.1 (1984)
Sewers (percent)	36.0 (1986)	72.0 (1979)	97.0 (1976)	91.0 (1983)	65.0 (1975)
Per Capita Urban Parks (square meters)	2.2 (1985)	21.5 (1984)	30.4 (1976)	37.4 (1984)	12.2 (1984)

Notes:

1. Consumer durable goods index includes refrigerators, freezers, electric washing machines, color television sets, videocassette recorders, microwave ovens, pianos and stereo equipment per household. The average of the European nations and the United States is equal to 100.

   Source: Leisure Development Center, 13 Nations' Sense of Values Survey Data Book (1980).

2. Social capital index represents the percent of the population with sewer service, park area per person, length of highways per 100,000 vehicles, and the average number of people per room of a house. The average of the European nations and the United States is equal to 100.

   Source: United Nations, I.R.F. Annual Statistics Report, 1986, Annual Bulletin of Housing and Building Statistics for Europe, and Annual World Statistics Report.

3. Paved roads show the percent of total roads with simple paving.

4. Sewers indicate the percent of total households connected to a sewer system.

5. Per capita urban park is based on Tokyo for Japan, Los Angeles for the United States, London for Britain, the national average for West Germany and Paris for France.

Source: Ministry of Construction

The Best is Yet to Come

It is clear that Japan has achieved much of what the Maekawa commission recommended. It also is clear that just as much remains to be done. The next tasks will be more difficult to achieve since they require a good deal of time or great political will to solve. Problems that can be solved only over time include raising the social capital stock, dealing with the Third World debt problem, increasing Japan's contribution to science and technology, and restructuring the domestic market to focus on domestic demand. None of these is overly difficult, just time consuming. The question is whether the world can wait for Japan to take the necessary actions. Particularly with regard to economic restructuring, it is not at all certain that the current global economic system can withstand the strain of persistently large current account imbalances.

Other problems, such as land use reform, agricultural reform and macroeconomic coordination, are in a different class. These problems can lead to wrenching changes in the social, the political and the economic life of Japan. Land use and agricultural reform are especially sensitive issues, resembling a Gordian knot. More rational use of Japan's limited land resources would ease the housing situation, reduce the barriers to agricultural reform and probably lead to an increase in the standard of living. Strong political leadership will be needed to weld a domestic consensus on how to achieve these goals. Similarly, attaining true macroeconomic coordination requires an attitude of concern for global matters that is not present even in such an internationally minded country as the United States. This goal may never be attained -- and some would argue that this is a positive limitation.

Finally, it is not certain that the basic underlying goal of the Maekawa reports -- to change the perceptions of Japan's global role at the grass-roots level -- can be achieved any time soon. Without such a change, Japan's commitment to international growth and harmony may be perceived cynically abroad as an exercise in expanding influence. As any American politician who has tried to interest the average citizen in foreign policy knows, it is difficult to get people to widen the scope of their concerns beyond personal boundaries. To sustain such a broader interest at the national level is even more difficult. Nevertheless, there are already signs that some concepts, such as Japan's responsibilities as an economic power to aid developing countries, are taking hold in the popular mind. Even if the Maekawa reports are never fully implemented, they will be a success if they contribute to a broadened Japanese mindset.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.